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The Wisconsin State Income Tax

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Abstract

The state of Wisconsin has the oldest continuously operating state income tax in the United States. In this brief I discuss some of the history and background of the state income tax, as well as the current distribution of taxes and effective tax rates. The state has a progressive income tax system, with statutory marginal tax rates that increase with income. In recent years, the state income tax has accounted for about 45% of Wisconsin's state tax revenue, and amounted to around 3% of total personal income. In 2019, over 3.1 million taxpayers filed state returns, paying on average \$2,639 in state income taxes, at average effective rate of 4.32%. Across the distribution, average effective tax rates increased from 1.3% to 5.6%. The progressive nature of the tax system, along with the skewed distribution of income, means that most state income taxes are paid by high income filers. In 2019, the bottom 40% of filers, with incomes less than \$26,600 paid only 1.5% of all state income taxes, while the top 20% of taxpayers, who had incomes over \$85,330, accounted 72.6% of income tax revenue. Accounting for exemptions, deductions, and tax credits, the filers that accounted for the vast majority of all income tax revenue paid effective marginal tax rates around 5.8%.

1. Background on the Wisconsin State Income Tax

“Prior to 1912, the history of state income taxes in this country failed to disclose a single instance in which the tax had been successful as a revenue producer or had justified itself as a practical or desirable method of taxation.... In the face of these experiences it is somewhat remarkable that the people of Wisconsin should suddenly -- and apparently spontaneously -- reach the conclusion that a state income tax was necessary and desirable.” Kennan (1915).

Although it is often claimed that in 1911 Wisconsin became the first state to establish an income tax (Ohlin, 2019), a more accurate claim is that it was the first state to implement a *workable* income tax (Stark, 1987). As the quote above notes, other states had tried and failed to tax incomes, while Wisconsin’s income tax started in 1911, two years before the ratification of the Sixteen Amendment allowed for a federal income tax, and has remained in place ever since.

From the beginning, the Wisconsin income tax was highly progressive, with the first \$1,000 of income taxed at 1% and each additional \$1,000 taxed at higher marginal rate, up to a top rate of 6% on income over \$12,000, which is over \$346,000 in 2021 dollars. Over time the tax rates and tax brackets have been regularly adjusted, with the top tax rate hitting a peak of 11.4% from 1972-1978, but remaining at 10% or more from 1962-1986 (Ohlin, 2019). With increases in tax rates and an expansion of the tax base, came an increase the tax collections, as shown in Figure 1. The left panel shows that the income tax grew from 12.6% of state tax revenue in 1942 to over 42% by 1969, and in recent years has varied between 40-45% of revenue. The right panel shows that income tax collections grew from 0.5% of total state personal income in 1942 to over 3% by the 1970s. State tax reforms in recent years have reduced that share from a peak of 3.7% in 2000 to an average of 2.7% over the past decade.

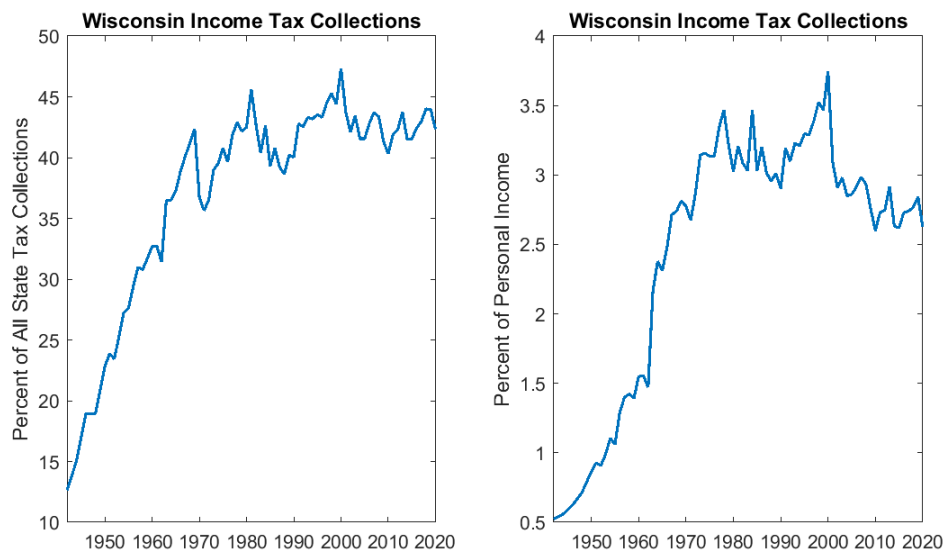


Figure 1: Wisconsin income tax collections as a percentage of all state tax collections (left panel) and as a percentage of total state personal income (right panel).

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In recent years, Wisconsin policymakers have focused on reducing rates more at the lower end, with the bottom rate falling from 4.6% in 2012 to 3.54% in 2021, while the top rate was cut by only 0.1 percentage points in 2013 and has remained at 7.65% ever since. These changes have reduced Wisconsin's state and local tax burden, which according to the Tax Foundation fell from 11.7% in 2010, and a ranking of 46th highest, to 10.7% in 2019 and a ranking of 37th highest (York and Walczak, 2021). But while the state has become more competitive, it remains among the highest-taxed states. Moreover, the state's high top income tax rate (9th highest in the US) is a particular barrier to economic growth as the vast majority of businesses in the state pay personal, rather than corporate, income taxes. Thus the top income tax rate serves as a tax on business capital, leading to lower investment, employment, and output.

2. Current Wisconsin Income Tax and Comparisons

The state of Wisconsin relies heavily on its personal income tax. The Legislative Fiscal Bureau recently announced that in preliminary data actual collections for fiscal year 2020-2021 the personal income tax brought in \$9.28 billion, or more than 47% of the \$19.57 billion in total state general fund tax collections (Lang, 2021). The state income tax structure is progressive, with statutory marginal tax rates that increase with income. But the tax code has a number of credits and deductions which phase in and out, meaning that the effective rates that taxpayers face may differ quite sharply from statutory rates. In fact, as we show below, under current law families of four with incomes around \$50,000 face the highest effective marginal tax rate of 9.83%, more than two percentage points above the statutory 7.65% top rate for the highest earners.

Under the state individual income tax, Wisconsin taxable income is multiplied by the applicable tax rates to arrive at gross tax liability. Currently, the state employs four tax brackets, with a separate tax rate assigned to each bracket. The tax rate structure is cumulative so that each tax rate applies only to income that falls within the corresponding bracket. A taxpayer with income exceeding the threshold for the top bracket would have income subject to each of the four tax rates. The tax brackets vary by filing status and are indexed annually for inflation. Table 1 shows the tax rate schedule for singles and married filing jointly for tax year 2020. The statutory marginal tax rate takes one of four values depending on filing status and taxable income. For tax year 2021, the marginal tax rate for the third bracket will fall from 6.27% to 5.3%. (See Guo and Williams (2021).)

Table 1. 2020 Individual Income Tax Rate Schedule

Marginal Tax Rate (%)	Taxable Income Brackets (\$)	
	Single	Married Filing Jointly
3.54	0 – 11,970	0 – 15,960
4.65	11,970 – 23,930	15,960 – 31,910
6.27	23,930 – 263,480	31,910 – 351,310
7.65	263,480+	351,310+

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As discussed above, the overall tax burden in Wisconsin has fallen slightly in recent years, largely driven by reductions in income taxes in the lower tax brackets. However, as I discuss in more detail below, most income taxes are paid by higher income filers, and much of the income from these higher income filers consists of pass-through business income. Thus while the overall tax burden has fallen with modest cuts in *average* tax rates, *marginal* tax rates – which matter for most economic decisions and drive growth impact – have been less impacted.

How High Are Individual Income Tax Rates in Your State?

Top State Marginal Individual Income Tax Rates, 2021

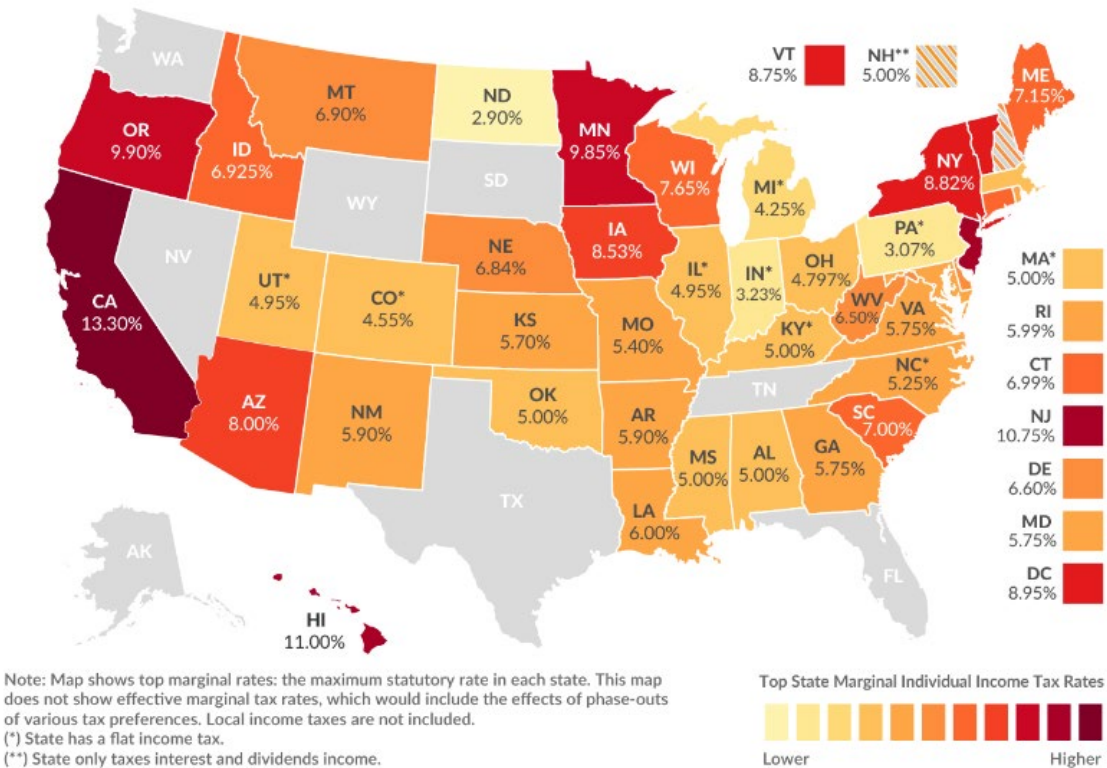


Figure 2: Top state marginal income tax rates across the United States. (Source: Loughhead, 2021).

In fact, Wisconsin's top marginal income tax rate of 7.65% remains one of the highest in the country. As shown in Figure 2, which is drawn from Loughhead (2021), Wisconsin's top rate is the 9th highest of the 42 states in the US that tax income. Of the states in the Midwest, only Iowa and Minnesota have higher top rates. Apart from those two, most of the high income tax states are on the coasts, led by California, Hawaii, New Jersey, Oregon, and New York (with New York City having an additional progressive city income tax of over 3%). On the flip side, eight states have no income tax at all: Alaska, Florida, Nevada, South Dakota, Tennessee, Texas, Washington, and Wyoming.

Of course, the impact of income taxes depends on more than just the statutory tax rates, as the tax code has many exemptions, deductions, and credits. Explicit calculations in Guo and

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Williams (2021) show effective marginal tax rates for a hypothetical family of four with varying income. Here, to get a broader picture of the distribution of taxes paid and effective tax rates, I use data from Wisconsin Department of Revenue on tax return filings.¹ Table 2 summarizes the data from the 3,132,910 tax returns filed in 2019.

Table 2: Wisconsin Income Tax Distribution, 2019

	total	Bottom 20 percent	20th to 40th percentile	40th to 60th percentile	60th to 80th percentile	80th to 95th percentile	95th to 99th percentile	top 1 percent
Average:								
Income per return	\$61,105	\$1,153	\$17,595	\$36,108	\$63,416	\$116,316	\$232,143	\$1,071,779
Net Tax per return	\$2,639	\$15	\$183	\$950	\$2,471	\$5,521	\$12,244	\$59,683
Net Tax/Income Marginal rate	4.32%	1.32%	1.04%	2.63%	3.90%	4.75%	5.27%	5.57%
			1.02%	4.14%	5.57%	5.77%	5.80%	5.65%
Share of income		0.38%	5.76%	11.82%	20.76%	28.55%	15.20%	17.54%
Share of net tax		0.12%	1.39%	7.20%	18.73%	31.39%	18.56%	22.62%

The table shows that the average income of filers was \$61,105 and the average (net) tax paid was \$2,639, for an average effective income tax rate of 4.32%. Across the distribution, average effective tax rates increase from 1.3% to 5.6% reflecting the progressive tax structure. Even at the top end of the income distribution, average effective rates are well below statutory marginal rates due to deductions and credits, as well due to the varying rates at which different amounts of income are taxed.

Given the progressive nature of the tax system and the skewed distribution of income in the state, most of the income taxes are paid by higher income filers. In particular, the bottom 40% of filers, with incomes less than \$26,600 paid only 1.5% of all state income taxes in 2019, while the top 20% of taxpayers, who had incomes over \$85,330, accounted 72.6% of income tax revenue. Further, the distribution of tax returns has more low-income filers than the household income distribution in the state. According to the Census Bureau, the median household income in Wisconsin in 2019 was \$64,168 in 2019, slightly higher than both the average income of filers overall and the \$63,416 average income of filers 60th-80th percentile range. Filers in that quantile paid an average effective rate of 3.90%, slightly lower than the overall average.

¹ See <https://www.revenue.wi.gov/Pages/RA/Individual-Income-Tax-Statistics.aspx>

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The table also provides a simple calculation of average effective marginal tax rates across the income distribution. For this calculation, I compare the increase in the average tax bill to moving up the reported quantiles of the distribution to the increase in average income. Rather than looking at the true marginal tax rate on the last dollar earned, this gives a measure of the average effective tax rate on incremental income, taking into account that deductions may increase with income. This average marginal rate is also progressive, increasing with income, but both increases and flattens out relatively quickly at around 5.8% for the income groups that account for most of the income taxes that are paid.

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